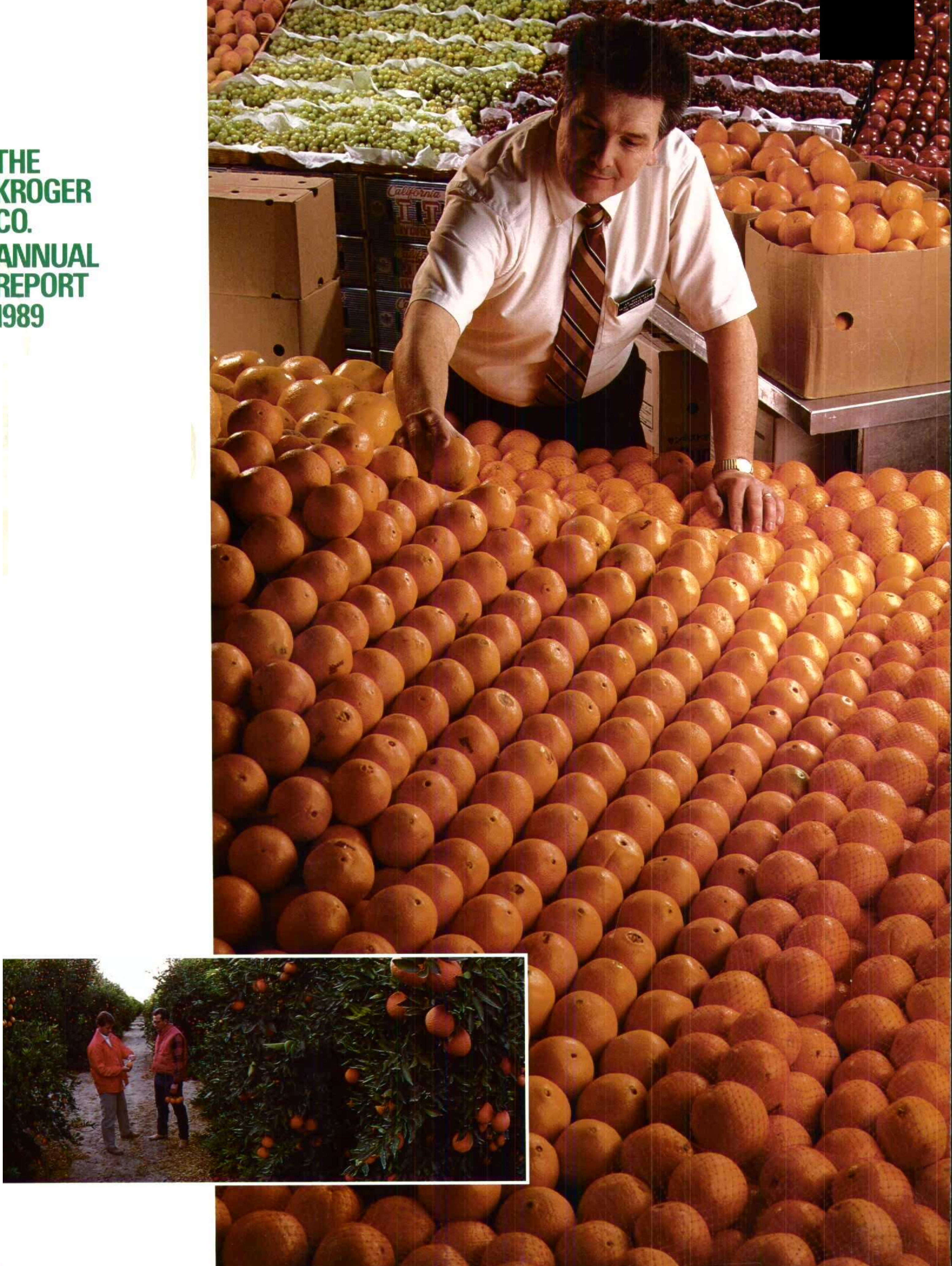
THE KROGER CO. ANNUAL REPORT 1989



ON THE COVER:

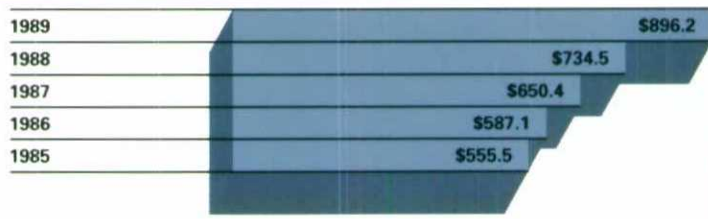
In the midst of controversy about the safety of fruits and vegetables sold in the nation's supermarkets, The Kroger Co. assures the quality and wholesomeness of its fresh produce in a number of ways. First, we purchase produce *directly* from reputable growers through the Company's Wesco buying organization. Second, we employ an outside laboratory to randomly sample fruits and vegetables to make sure our produce adheres to strict government tolerances for pesticide residue. Third, we are working with producers to promote natural techniques for pest-free growing.

The result is continuing customer satisfaction—and assurance—in the quality of produce in The Kroger Garden.

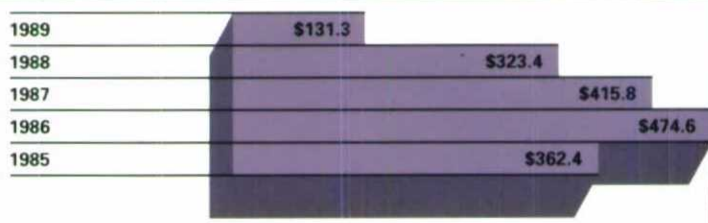
This is a summary annual report of The Kroger Co. for 1989. It is intended to give readers an overview of the Company's financial results and business strategy. Detailed financial information will be included with the corporate proxy statement that will be mailed in early April to each Kroger shareowner.

SALES
(FROM CONTINUING UNITS)
(BILLIONS)

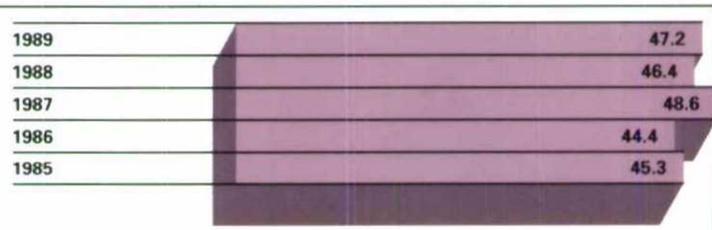
CASH FLOW
(FROM CONTINUING UNITS)
(MILLIONS)



CAPITAL EXPENDITURES
(MILLIONS)



SUPERMARKET SQUARE FOOTAGE
(MILLIONS OF SQUARE FEET)



FINANCIAL HIGHLIGHTS

NOTE: These financial highlights should be read in conjunction with the audited financial statements that will be included with the proxy statement.

	1989 (52 weeks)	1988 (52 weeks)	1987 (52 weeks)
Sales:			
Continuing Units	**$ 18.8 billion**	$ 17.5 billion	$ 16.4 billion
Increase over prior year	**7.5%**	6.8%	1.3%
Total Company	**$ 19.1 billion**	$ 19.1 billion	$ 17.7 billion
Increase over prior year	**.3%**	7.9%	3.1%
Operating Cash Flow:[a]			
Continuing Units	**$ 896.2 million**	$734.5 million	$650.4 million
Total Company	**$ 900.2 million**	$755.6 million	$648.3 million
Interest Expense, Net	**$ 633.1 million**	$197.6 million	$ 95.8 million
Net Earnings	**$(72.7) million[b]**	$ 34.5 million[c]	$246.6 million[d]
Earnings per Common Share	**$ (.92)[b]**	$ .24[c]	$2.99[d]
Capital Expenditures	**$ 131.3 million**	$323.4 million	$415.8 million
Real Estate Data:			
Food stores			
Opened and acquired	**26**	59	100
Total at year-end	**1,234**	1,240[e]	1,317
Convenience stores			
Opened and acquired	**17**	82	160
Total at year-end	**956**	958	889

(a) Operating cash flow equals earnings before interest, depreciation, restructuring charges/credits, extraordinary items, LIFO charge and taxes based on income.

(b) Includes an after-tax credit of $11.9 million, or 15 cents per share for gains from the sales of divested units and an after-tax extraordinary charge of $56.4 million, or 69 cents per share from the early retirement of debt and the writeoff of deferred costs associated with entering into the credit agreement and cancelling the related interest rate protection agreements.

(c) Includes charges of $129.9 million, or $1.64 per share, after-tax, for expenses related to restructuring.

(d) Includes an after-tax credit of $3.8 million, or 5 cents per share, for overestimation of restructuring costs, and includes a one-time credit of $63.3 million, or 79 cents per share, for a change in accounting for income taxes.

(e) Excludes 55 units divested or in the process of divestiture.

TO OUR FELLOW SHAREOWNERS:

Last year's annual report outlined The Kroger Co.'s principal goals for 1989: build sales, improve cash flow, and effectively manage the debt taken on in the 1988 corporate restructuring. Success depended upon Kroger operating well-run stores, maintaining competitive prices, keeping costs firmly in line, and fostering a spirit of teamwork among all employees.

We are pleased to report that each of these goals was met or exceeded:

- Supermarket and convenience store sales from continuing units improved by 7.5 percent over 1988. Sales from stores open all year—a key measure of Kroger's retail strength—increased 5.3 percent.
- Operating cash flow from continuing units increased 22 percent, well beyond the 16 percent gain originally projected when the restructuring plan was implemented in September, 1988.
- Debt, including capital leases and preferred stock, was trimmed by $413 million and the Company's overall debt structure was reshaped to reduce total interest costs, extend repayment schedules, and increase operating flexibility.
- Incentive payments tied to store, division, or overall corporate results were extended to more Kroger employees. Such incentives are helping to enhance productivity and promote a sense of team unity in the workplace.

This performance is significant in two respects.

First, it demonstrates the organization's ability to execute an aggressive business plan based upon the principles of cash flow management.

Second, Kroger is now better able to take advantage of business growth opportunities than it was just after restructuring. Cash-draining assets have been sold, and we have withdrawn from problem markets. Our retailing units are efficient and productive, as reflected in the upward momentum of identical store sales throughout 1989.

Kroger stores are contemporary and precisely designed for the needs of modern-day consumers. Many of the 533 "superstores," which feature a selection of specialty departments surrounding a traditional grocery store core, are being upgraded and remodeled. The 589 larger-scale food and drug "combination" stores have become Kroger's primary growth vehicle. They are producing substantial additional sales in service-oriented departments such as pharmacies, cosmetics and fragrance counters, and video stores. Our stores are served by state-of-the-art manufacturing facilities and one of the industry's most efficient distribution systems.

Kroger customers continue to be well-served by the Company's most valuable resource: our thousands of talented and motivated employees. Without sacrificing service or quality, employee-related costs are being held in check and productivity is improving. Employees voluntarily purchased substantial amounts of Kroger common stock through 401(k), profit sharing, and Kroger Stock Exchange programs in 1989. Employees and their benefit plans own approximately 34% of Kroger's outstanding common stock. This ownership stake is a substantial motivating factor underlying the Company's fine performance.

In summary, 1989 was a year of exceptional progress. Kroger

(left) **Lyle Everingham, *Chairman & Chief Executive Officer***
(right) **Joseph A. Pichler, *President & Chief Operating Officer***

adjusted to the constraints imposed by the corporate restructuring; met customer expectations; strengthened our presence in major retail markets; and responded to competition with attractive prices, contemporary store facilities, and broad merchandise selection.

The Challenge Ahead

Kroger has $4.9 billion of debt still on the balance sheet. Our efforts must be devoted to reducing this obligation. To do so, we are redoubling our commitment to produce strong sales while maintaining a firm hold on expenses.

Our Company also faces difficult challenges that will gather force during the next decade. We must find, train and retain skilled employees despite a significant projected decline in the nation's available labor pool. The management of solid waste is an issue of growing prominence. Food safety and health issues are already in the forefront of consumer concerns.

Kroger's business plan for 1990 projects continued increases in operating cash flow and sales growth above inflation. We can expect to be strongly challenged by our competitors, who have been aggressive in attempting to take advantage of what they perceive to be Kroger's financial vulnerability.

Kroger is prepared for these challenges. The progress achieved in 1989 has given the Company strong momentum. We move into the last decade of this century committed to continued growth in our business and dedicated to serving Kroger shareholders, employees, communities and, of course, our customers.

Lyle Everingham

Lyle Everingham
Chairman and Chief Executive Officer

Joseph A. Pichler

Joseph A. Pichler
President and Chief Operating Officer

March 1, 1990

BUSINESS REVIEW

The improvement in Kroger's financial position in 1989 was the direct result of the strong retail performance by the Company's 1,234 supermarkets and 956 convenience stores, plus effective expense management at all levels of the organization.

Operating Results

Sales—Company sales from continuing units reached $18.8 billion in 1989, an increase of 7.5 percent over 1988.

Sales improvement was well-balanced regionally. Among the 16 supermarket divisions of the Company, gains ranged from 3 percent to more than 15 percent.

Kroger's seven convenience store divisions had combined sales of $782.7 million, more than 12 percent above 1988. Four of the divisions produced overall sales improvements above 10 percent. Gasoline, which is sold at most of the convenience store outlets, was a significant factor in this increase.

Sales from Kroger's 40 food processing plants to customers outside the Company increased 9.2 percent, despite the divestiture-related reduction in the number of plants.

Operating Cash Flow—Operating cash flow in 1989 totaled $896 million from continuing units, a 22 percent improvement over 1988. Cash flow increased to 4.76 percent of sales.

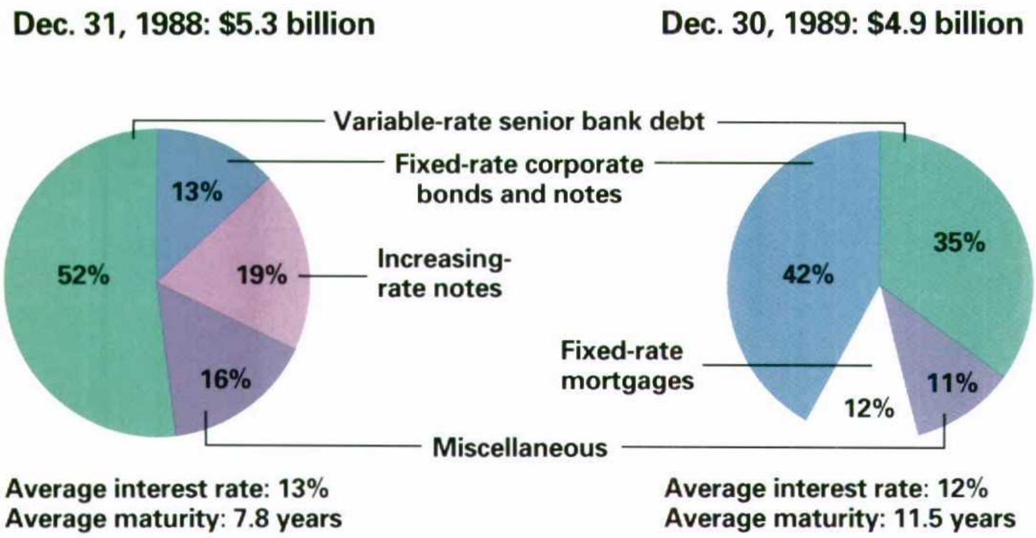
The impact of interest expense and restructuring-related costs, plus a one-time charge against earnings of $56.5 million from the write-off of costs related to the Company's initial restructuring credit agreement, resulted in a net loss for the year of $72.7 million.

Expense control was reflected in substantially lower overhead costs. General Office expenses were reduced by $15.7 million, and the Company's operating divisions also cut overhead. Many labor contracts negotiated during the year limited fixed cost increases but provided incentive payments linked to division and store results. In 1989, these payments surpassed $14 million.

Debt Management

Kroger's debt management strategy in 1989 targeted three

KROGER TOTAL DEBT YEAR-END 1988 VS. YEAR-END 1989



primary goals: reducing interest expense, lengthening the maturity of the debt, and leveling out principal payments.

All these goals were achieved. At the beginning of 1989, Kroger's outstanding debt totaled $5.3 billion, consisting of debt already on the books plus bank loans used to pay shareholders the special $48.69 per share restructuring dividend.

In a series of financial transactions during 1989, Kroger began reducing debt and stretching out repayment schedules. Some Company-owned assets were divested, and long-term notes were sold publicly. The proceeds were used to pay down the bank loans, including a $300 million divestiture loan which was fully repaid in June, 1989, eighteen months earlier than scheduled.

Late in the year, Kroger successfully completed a $612 million mortgage financing package, replacing a portion of its bank debt with longer term, lower cost mortgage debt. Concurrently, the Company negotiated a favorable restatement of the terms of its original credit agreement. The floating interest rate on the new credit agreement is lower by approximately ¾ of 1%.

By year's end, Kroger's overall debt had been reduced by approximately $413 million. The major portion of the remaining $4.9 billion debt consisted of an available $2.05 billion credit facility, made up of a $1.2 billion bank loan and a revolving line of credit of up to $850 million for working capital and other general corporate purposes. (Early in 1990, Kroger replaced $250 million of the bank debt with 11⅛% 8-year senior notes.)

Total interest expense on Kroger's debt in 1990 is expected to be approximately $590 million. This compares to the approximate $637 million originally estimated for 1990 at the time of the corporate restructuring. Annual scheduled principal payments under the credit agreement have been leveled at approximately $159 million. "Stepdown" provisions in the restated credit agreement permit further reductions of up to ¾ of 1% in interest costs over the next 18 months based upon cash flow improvements.

Capital Spending

Kroger maintained a strong capability during 1989 to commit capital for new store facilities and renovations despite the constraints imposed by the credit agreement. The Company continued to strengthen its position in its major markets by building or remodeling 195 retail stores—representing approximately 10 percent of the total store base.

Kroger plans to build an average of 40 new food stores and to remodel about 100 existing facilities in each of the next four years.

Other Developments

In May, Kroger reduced its ownership in its membership warehouse subsidiary, Price Savers Wholesale, Inc. The Company retained a 22 percent equity interest. This investment, as well as a minority investment in Hook-SupeRx, Inc., increased significantly in value during 1989.

In the fall, the Company completed the sale of its dairy and bakery units in St. Louis and a dairy in Texas.

Richard L. Bere was appointed Senior Vice President, responsible for Kroger supermarket operations in Indiana, Texas, Tennessee, Georgia,

South Carolina, and Alabama. He succeeded David A. Burt, who retired after 45 years of distinguished service.

William D. Atteberry, a Member of the Board of Directors, will retire from the Board in April, 1990, after a decade of outstanding contributions to the Company.

Corporate Responsibility

Kroger and its employees actively participated in a broad array of civic and charitable causes during 1989.

The "Round Up for the Hungry" program—Kroger's innovative effort to involve shoppers in providing perishable food for the needy—completed its second year, generating more than $600,000 to date.

Among the most notable examples of community involvement was the assistance lent by Kroger store and transportation employees—and Kroger customers—to cities and towns devastated by Hurricane Hugo in September.

In metropolitan Atlanta, customers donated 642,800 pounds of food—all of it collected in just four days. Truck drivers from Kroger's Atlanta division voluntarily transported the donated food to hurricane victims. Other Kroger divisions assisted with shipments of bottled water and food.

A group of store employees in Baytown, Texas, received the Company's annual B.H. Kroger Employee Group Award for Community Service for their support of Special Olympics, the March of Dimes, the Muscular Dystrophy Association, and Big Brothers and Big Sisters. A Harrisburg, Ill., store employee, Richard A. Nelson, received the individual B.H. Kroger Award in recognition of his involvement with a variety of youth, civic and charitable activities.

The Kroger Co. Foundation made 1,284 contributions totaling some $3.67 million during 1989. This represents a significant increase in charitable giving and is reflective of the Company's ongoing commitment to good corporate citizenship.

FOOD SAFETY & KROGER

Throughout 1989, food safety issues dominated the public's perception of the supermarket industry. Headlines about Alar on apples, hormone treatments of dairy cattle, and cyanide-laced Chilean grapes, repeatedly confronted—and confounded—American consumers. As the year wound down, so did confidence concerning the safety of the nation's food supply.

For Kroger and other food retailers, the heightened visibility of the food safety issue posed an especially difficult challenge. Anxious consumers are calling upon the supermarket industry to assume greater responsibility for insuring a safe food supply.

How is The Kroger Co. responding?

As one of the nation's largest food retailers, Kroger's public statements and actions are closely monitored by competitors, the Congress, the news media, consumer organizations, food processors and growers, and—most important of all—Kroger customers.

Kroger's position on food safety has consistently emphasized these points:

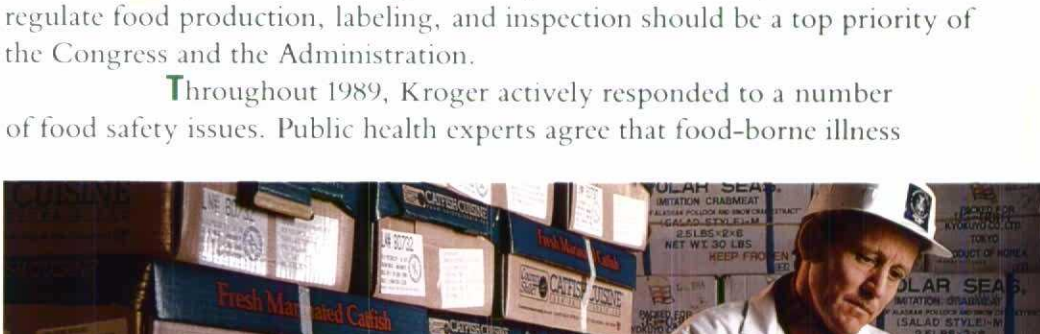
(1) As the purchasing "agent" for our shoppers, Kroger's responsibility is to provide wholesome products that consumers want, at fair prices. The safety of these products is best assured by purchasing commodities only from the most reputable, experienced growers and manufacturers and selling them in sanitary, well-maintained shopping environments.

(2) Kroger recognizes that it is responsible for food safety in areas over which it has direct control, such as the quality control of Kroger manufactured products and the maintenance of sanitary retail stores, warehouses and manufacturing plants.

(3) The primary responsibility for setting and enforcing standards that assure the safety of the nation's food supply rests with the federal government; specifically, the U.S. Department of Agriculture, the Food and Drug Administration, and the Environmental Protection Agency.

(4) Efforts to strengthen the government's ability to monitor and regulate food production, labeling, and inspection should be a top priority of the Congress and the Administration.

Throughout 1989, Kroger actively responded to a number of food safety issues. Public health experts agree that food-borne illness



In 1989, Kroger launched the supermarket industry's most comprehensive voluntary seafood inspection program, using Department of Commerce personnel to check fresh and frozen fish before shipment to Kroger Food Stores. The Company supports *mandatory* federal seafood inspection as the best way to insure a consistently wholesome supply of this increasingly popular item.

Seafood in Kroger Seafood Shoppes is known for its freshness and variety. Now, Kroger shoppers know it for something in addition: the assurance of quality backed by government inspection.

American consumers are increasingly interested in a healthful, nutritious diet. Kroger food processing plants responded to this concern during 1989 by replacing animal fat and tropical oils with cholesterol-free vegetable shortening in bread, rolls, pastries, cookies, and crackers. The change lowers the amount of saturated fat in Kroger's extensive line of bakery products.

The result is fresh baked products from the Kroger Bakery that are even better than before.

poses the single greatest food safety problem. Such illnesses are often caused by the improper storage and handling of perishable food products.

During 1989, the Company undertook a broadscale review of its food handling procedures in meat, seafood, salad bar, and delicatessen departments. Training sessions in safe food handling are systematically provided for all employees in these departments.

Kroger was among the first food retailers to initiate a voluntary, comprehensive federal seafood inspection program. U.S. Department of Commerce inspectors randomly check all fresh and processed seafood products before shipment to our stores.

The Company uses an outside laboratory to test produce shipments for pesticide residue. Kroger's purpose is to insure that our produce suppliers adhere to the pesticide tolerance levels prescribed by the federal government.

We also expanded our toll-free Product Information Line from meat and seafood to answer call-in questions concerning the proper storing and cooking of all food products. More than 31,000 customers took advantage of this service during 1989.

As the 1990s unfold, our strategy in food safety and health-related issues will be guided by a simple premise: we will take whatever action is appropriate to protect the interests of the millions of customers who shop in our stores.

At the same time, we will continue advocating a strengthened hand for the federal government in the food safety area. Adequate resources and personnel for government agencies with food safety responsibilities must be allocated. An equal priority is the development of a national food safety strategy. Government agencies, legislators, retailers, manufacturers, and consumer groups must work together to build consensus around such pressing issues as mandatory seafood inspection and consistent, uniform food labeling standards.

With a coherent food safety strategy and clearly defined roles for the federal government, food processors and growers, and food retailers, the 1990s could be the time when consumers regain confidence that America's food supply is safe, wholesome, and reliable once again.

CORPORATE OFFICERS

RICHARD L. BERE
Senior Vice President

DAVID B. DILLON
President and
Chief Executive Officer
Dillon Companies, Inc.

RICHARD W. DILLON
Chairman of the Board
Dillon Companies, Inc.

DONALD F. DUFEK
Senior Vice President

LYLE EVERINGHAM
Chairman of the Board and
Chief Executive Officer

PAUL W. HELDMAN
Vice President and
General Counsel

ROBERT J. HODGE
Senior Vice President

JACK G. HUDSON
Group Vice President

LORRENCE T. KELLAR
Group Vice President

THOMAS E. MURPHY
Group Vice President

JACK W. PARTRIDGE, JR.
Group Vice President

JOSEPH A. PICHLER
President and
Chief Operating Officer

WILLIAM J. SINKULA
Senior Vice President

NORMA SKOOG
Vice President and Secretary

LAWRENCE M. TURNER
Vice President and Treasurer

BOARD OF DIRECTORS

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Eagle-Picher Industries, Inc.

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ADT Security Systems, Inc.

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Chief Executive Officer
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Chairman of the Board
Dillon Companies, Inc.

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Chairman of the Board and
Chief Executive Officer
The Kroger Co.

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Former Chairman of the Board
and Chief Executive Officer
Entex, Inc.

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Senior Partner
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Executive in Residence
School of Business
University of Louisville

THOMAS H. O'LEARY [5,6]
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The Kroger Co.

DR. W. GEORGE PINNELL [1,3,4]
Executive Vice President Emeritus
Indiana University

OTIS M. SMITH [1,3]
Of Counsel
Lewis, White & Clay

Board Committees
(as of 1/1/90)

1 Audit
2 Compensation
3 Corporate Responsibility
4 Executive
5 Financial Policy
6 Nominating

KROGER STOCK OWNERSHIP PLANS

The Company has a variety of individualized plans designed to allow both employees and general shareowners to acquire stock in Kroger.

EMPLOYEES: Kroger employees and employee benefit plans own shares through non-contributory ESOPs, pension plans and a profit sharing plan, as well as employee-funded 401(k) plans and a payroll deduction plan, called the Kroger Stock Exchange. As of December 31, 1989, these plans in the aggregate owned approximately 34% of the Company's outstanding shares. If employees have questions concerning their shares in the Kroger Stock Exchange, or if they wish to sell shares they have purchased through this plan, they should contact:

Star Bank, N.A. Cincinnati
P.O. Box 5277
Cincinnati, Ohio 45201
Toll Free 1-800-234-8321

Questions concerning any of the other plans should be directed to the employee's local Human Resources Manager.

GENERAL SHAREOWNERS: Individuals may make commission-free initial cash contributions to purchase Kroger shares through a special plan administered by First Chicago Trust Company of New York. For information concerning this plan, or for questions concerning changes of address, etc., individual shareowners should contact:

First Chicago Trust Company of New York
30 West Broadway
New York, New York 10007-2192
1-212-791-6422.

For information concerning the 15½% Junior Subordinated Discount Debentures Due 2008, contact:

Bankers Trust Company
P.O. Box 9006, Church Street Station
New York, New York 10249
1-212-250-6000.

GENERAL INFORMATION

General Information for all Shareowners:

Form 10-K—A copy of the Company's 1989 report to the Securities and Exchange Commission, Form 10-K, is available on request by writing: Lawrence M. Turner, Vice President and Treasurer, The Kroger Co., P.O. Box 1199, Cincinnati, Ohio 45201-1199, or by calling 1-513-762-1220.

Annual Meeting—The Kroger annual shareowners meeting will be held at the Clarion Hotel in Cincinnati on May 17, 1990, at 10 a.m.

Stock Trading—The main trading market for The Kroger Co.'s common stock is the New York Stock Exchange, where it is listed under the symbol KR.

Independent Certified Public Accountants—Coopers & Lybrand, 1500 Atrium One, 201 East Fourth St., Cincinnati, Ohio 45202

Shareowners—At the end of 1989, a total of 63,791 shareowners of record owned 83,720,299 shares of Kroger's common stock.

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